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## Fitch Affirms Hidrovias' Ratings at 'BB-'; Outlook Stable

Fitch Ratings - Rio de Janeiro - 06 Oct 2023: Fitch Ratings has affirmed Hidrovias do Brasil S.A.'s (Hidrovias) Long-Term Foreign (FC) and Local Currency (LC) Issuer Default Ratings (IDR) at 'BB-', its National Long-Term Rating and its unsecured debentures at 'AA-(bra)'. The Rating Outlook is Stable.

Hidrovias' ratings reflect its good position in the waterway transportation industry in the North and Central-West of Brazil and in the Parana-Paraguay river system, where logistics infrastructure is relatively limited. Hidrovias' take-or-pay contract business model, with more than 60% of EBITDA coming from long-term agreement helps to partially mitigate volume volatility. The ratings are tempered by its exposure to hydrological risks and/or crop failures and client concentration.

The ratings also incorporate Fitch's expectation that Hidrovias will continue to maintain its deleveraging trend, reducing expansion capex, and its solid liquidity position. The company is expected to be proactive to refinance its 2025 bonds outstanding bond maturity before mid-2024, seeking to avoid refinancing risks.

### Key Rating Drivers

**Cash Flow Volatilities Despite Take or Pay Contracts:** Hidrovias' business resilience faces challenges due to hydrological risks and/or agricultural crop failures. Over the past few years, the company's operating performance has been impacted by a combination of drastic non-manageable events. The hydrological risk on its South Corridor has now eased with the recovery in water levels in the Parana-Paraguay River system. The North and Northeast of Brazil are facing a severe drought, with significant impact on the Madeira-Amazonas River system. Hidrovias' area of operations has not been impacted yet, and it has a track record of much lower water level seasonality.

**Diversification Helps Attenuate Hydrological Risk:** In a sensitivity scenario of EBITDA loss in the North Corridor during 2024 as result of the drought, Hidrovias' credit metrics would still show some rating headroom within Fitch's rating sensitivities triggers. In Fitch's base case, net leverage metric would remain in line with 'BB-' rating triggers (below 4.5x) with up to 30% loss in the North Corridor EBITDA. Above this threshold, Fitch would expect Hidrovias to better evaluate its expansion capex in order to preserve cash.

**Capital Allocation Remains Key:** Management's strategy of business diversification, growth (discretionary capex), and returns to shareholders is critical to determining leverage trends. Fitch expects that in the medium term Hidrovias will continue to invest to leverage its business scale, taking advantage of growth opportunities in the market it operates. Fitch estimates capex of around BRL370

million in capex during 2023 and then increasing to BRL380 million in 2024; these levels would still be lower than previously planned capex (BRL550-650 million). The more moderate business expansion is likely to lead to positive FCF in 2023 and 2024 of BRL97 million and BRL140 million, respectively. Nevertheless, in a drought scenario in the North Corridor part of the 2024 capex would most likely be postponed.

**Deleveraging Trend:** Hidrovias have been improving its operating cash flow generation over the past quarters with recovery in water levels in the South Corridor, record volume levels and efficiencies gains. Fitch's base case scenario estimates around BRL862 million of EBITDAR in 2023 and BRL995 million in 2024, up from BRL724 million in 2022. Free cash flow (FCF) generation during 2022 was BRL162 million and it should be BRL96 million during 2023, after higher capex of BRL370 million. For 2024, FCF is estimated at BRL139 million and capex of BRL380 million. Fitch expects net leverage to show significant improvement to 4.2x in 2023 and 3.5x in 2024. This compares with 5.3x in 2022 and average of 5.5x in the previous three years, per Fitch's calculations.

**Challenge to Increase Client Diversification:** Hidrovias has portfolio concentration risk, as its main clients are J&F Mineração (a former contract of Vale S.A. [BBB/Stable], COFCO Group and Alumina do Norte do Brasil S.A. [Alunorte]), which Fitch estimates together account for 48%-62% of total EBITDA on historical basis. In recent years, Hidrovias added new clients and sectors to its portfolio, including new service activities in Santos Port, but these additions only account for around 10% of EBITDA. During 2022, EBITDA breakdown by corridor was: North (55%), South (35%), Coastal (10%) and Santos (5%) (with holding and others representing 5% of expenses). Approximately 58% and 42% of EBITDA is generated in Brazil and Uruguay/Paraguay, respectively.

## Derivation Summary

Hidrovias's has the weakest position in the 'BB' rating category relative to transportation and logistics peers across the region, which are generally rated in the 'BB' to 'BBB' categories. Hidrovias' rating is constrained by its medium-size business scale, hydrological risks and weakest capital structure among Brazilian peers, including MRS Logística S.A. (BB/Stable), Rumo S.A. (BB/Stable), and VLI S.A. (AAA[bra]/Stable). Offsetting those factors are Hidrovias' competitive position in the region it operates and the majority of operations being based on take-or-pay contracts that helps to partially mitigate business volatility.

Hidrovias' expected 2023 net leverage is higher than other rated Brazilian peers in the transportation and logistics sector with more mature operations and with higher credit ratings. Rumo, VLI and MRS Logística are forecast to report 2023 net leverage below 2.5x in the next two years. Hidrovias' ratings incorporate expectations of net adjusted leverage ratio trending to 3.5x by 2024.

## Key Assumptions

Fitch's Key Assumptions Within the Rating Case for the Issuer:

--Strong Revenue growth in 2023, reflecting recovery in both South and North Corridor, reaching around BRL2 billion and around 13% growth in 2024;

- EBITDAR adjusted margin around 42%-43% in the next three years;
- Average capex of around BRL380 million in 2023-2025;
- No dividends payments during 2023-2024.

## **RATING SENSITIVITIES**

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

- Broader client diversification;
- Net debt/EBITDA consistently below 3.5x and total debt/EBITDA below 4.0x;
- Interest coverage consistently above 4.5x;
- Maintenance of strong liquidity to avoid refinancing risks.

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

- Large debt-funded M&A transactions or entering into a new business in the logistics sector that adversely affect its capital structure on a sustained basis or increase business risk exposure;
- Net leverage consistently above 4.5x on a sustained basis;
- Deterioration of liquidity position, with increasing short- to medium-term refinancing risks.

## **Liquidity and Debt Structure**

Good Liquidity Position, Refinancing Approaching: Hidrovias has a track record of maintaining strong cash balances. As of June 30 2023, the company's cash position was BRL726 million and BRL207 million of short-term debt. Fitch expects Hidrovias to remain proactive and to refinance its 2025 outstanding bond (BRL745 million) by mid-2024 in order to avoid greater exposure to refinancing risks.

As of June 30 2023, the company's total debt was BRL4.3 billion and included BRL2.6 billion of international bonds (60%) due 2025 and 2031, local debentures (22%), BNDES (11%) and leasing (5%).

## **Issuer Profile**

Hidrovias is an integrated logistics provider focused on waterways logistics services. It has an end-to-end infrastructure, including transshipment, port terminals and a fleet of barges, pusher tugs and cabotage vessels. The company operates in logistics corridors in the northern region of Brazil and in the Paraguay-Paraná river system.

## **REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING**

The principal sources of information used in the analysis are described in the Applicable Criteria.

## ESG Considerations

Hidrovias has a ESG Relevance score for Exposure to Environmental Impacts of '4', considering the effective impact on the company operations due the hydrological risks. Due to lower draft in rivers, the company stopped navigating for around 2 months in South Corridor (iron ore take or pay contract) during 2021. This has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit <https://www.fitchratings.com/topics/esg/products#esg-relevance-scores>.

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## Rating Actions

ENTITY/DEBT	RATING	RECOVERY	PRIOR	
Hidrovias International Finance S.a.r.l.				
• senior unsecured <sup>LT</sup>	BB-	Affirmed	BB-	
Hidrovias do Brasil S.A.	LT IDR	BB- ●	Affirmed	BB- ●
	LC LT IDR	BB- ●	Affirmed	BB- ●
	Natl LT	AA-(bra) ●	Affirmed	AA-(bra) ●
• senior unsecured <sup>Natl LT</sup>	AA-(bra)	Affirmed	AA-(bra)	

### RATINGS KEY OUTLOOK WATCH

POSITIVE	⊕	◇
NEGATIVE	⊖	◇
EVOLVING	◊	◆
STABLE	●	

### Applicable Criteria

[Corporate Rating Criteria \(pub.28 Oct 2022\) \(including rating assumption sensitivity\)](#)

[National Scale Rating Criteria \(pub.22 Dec 2020\)](#)

[Sector Navigators: Addendum to the Corporate Rating Criteria \(pub.12 May 2023\)](#)

## Applicable Models

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

## Additional Disclosures

### Solicitation Status

## Endorsement Status

Hidrovias do Brasil S.A. EU Endorsed, UK Endorsed

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